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Via Federal Express

January 28, 1997

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M. Street, N.W., Room 222
Washington, D.C. 20554

CC 96-263

Re: CC Docket No. 96-262 (In the Matter of Access Charge Reform)

Dear Mr. Caton:

We have enclosed an original and five copies of *Comments of California Cable Television Association* in the above referenced case. To confirm your receipt, please stamp and return to us the provided copy in the enclosed self-addressed stamped envelope.

Should you have any questions or require any additional information concerning this matter, please feel free to contact me.

Sincerely,

Alan J. Gardner

Enclosures (6)

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington D. C. 20554

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	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263
	)	

COMMENTS OF CALIFORNIA CABLE TELEVISION ASSOCIATION

CALIFORNIA CABLE TELEVISION ASSOCIATION
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January 28, 1997

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COMMENTS OF CALIFORNIA CABLE TELEVISION ASSOCIATION

I. Introduction and Summary of Position

The California Cable Television Association ("CCTA") submits these comments on the Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding. CCTA is a trade organization representing cable television operators with over 400 television systems in California, including both small and rural systems and multiple system operators. Most, if not all, of CCTA's larger members have Certificates of Public Convenience and Necessity ("CPCNs") in California for the provision of competitive local telephone services. As actual and potential facilities-based competitors, they need a federal and state market structure that is economically sound and will encourage investment and business growth. Enactment of economically sound access charges by the Commission will reflect reduced or eliminated subsidies as well as reflect economic costs, while providing for the recovery of legitimate network access costs.[1]

The Commission has proposed not only structural and rate changes in this proceeding, but the elimination of pricing safeguards which are essential for the development of competition. The pricing flexibility proposed by the Commission, and reliance on a "market approach", also as proposed by the Commission, is inappropriate prior to the existence of viable competition. Moreover, compensation for competitive losses is antithetical to a competitive market. As discussed herein, regulatory measures taken by the California Public Utilities Commission ("CPUC") indicates that these measures are unnecessary as well. California has reduced access and access subsidies with pricing safeguards in place and without any compensation for competitive losses today, and the ILECs are thriving.

II. Pricing Flexibility, and Reliance on the Commission's Proposed "Market Approach" is Inappropriate Prior to the Existence of "Actual" Sustainable Competition

The Commission has invited comment on a two-phased "market-based" approach to move access prices to more economically efficient levels and to foster "efficient competition to the benefit of customers wherever possible".[2] Under this market-based proposal, certain competitive safeguards, or "regulatory constraints" would be removed in an initial phase,

[1] CCTA specifically endorses the comments submitted by the National Cable Telephone Association ("NCTA") in this proceeding. CCTA is submitting these brief, separate comments to support NCTA's comments based on our California-specific experience.

[2] NPRM at paras 161, 168.

upon a demonstration by an ILEC that it faces "potential" competition in certain geographic areas.[3] These safeguards include: the limitation on geographic deaveraging; the ban on volume and term discounts for interstate access services; the current prohibition against contract tariffs and individual requests for proposals ("RFP") responses; and various restraints on the ability of ILECs to offer new, innovative access services.[4] A second phase of deregulation has been proposed upon a showing of an "actual" competitive presence in a relevant geographic area, including: eliminating price cap service categories within baskets, removing the ban on differential pricing for access among different classes of customers; ending mandatory rate structure rules for transport and local switching; and consolidating traffic-sensitive and trunking baskets.[5]

The Commission's proposal contravenes the axiom that the purpose of regulation is to provide certain benefits which are normally the product of a competitive market, under circumstances where competition does not fully exist. For the Commission to propose eliminating pricing safeguards in the face of only "potential" competition and prior to the existence of "actual" sustainable competition will not encourage the development of a competitive marketplace, and will allow the existing LECs to eliminate access competition as it enters the market.

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[3] NPRM at para 168.

[4] Id.

[5] Id. at para 201.

Sustainable competition is an inherent element of this analysis. If competition is not sustainable without pricing safeguards, then the elimination of those safeguards is directly contrary to the Commission's stated goals.

The reduction of nascent competition and elimination of the opportunity for real competition is a clear possibility under the Phase I proposal, where the Commission proposes to eliminate certain pricing safeguards in the face of **only** potential competition. Moreover, if adopted, there will exist no clear market signals as to the efficient level of pricing, or the cost of entering the market, when an ILEC can provide volume discounted, deaveraged contracts on a customer-specific basis, merely because that customer is the target of a competitive offer.[6]

Even under the Commission's Phase II proposal, the Commission takes great risk that competition will be eliminated, or at best, that competition will be severely constrained. For example, while the Competitive Access Provider ("CAP") industry today is admittedly growing, it only provides close to 1%[7] of access services today. The CAP market is absolutely reliant on the ILEC for access to all residential customers, as well as the majority of business customers. Allowing the ILEC to narrowly target CAP customers for volume discounts and term commitments, and to allow below-cost pricing will permit a LEC to eliminate a CAP

[6] The Commission has also suggested the possibility of allowing certain "Tariff 15"- type of activity, where an ILEC is provided the opportunity to provide a competitive response to customers who have obtained an offer from a competitor. While it can be debated whether this type of activity was appropriate in the interexchange market when it was authorized, prior to the existence of viable access competitors, the authorization of this type of competitive activity is nothing more than providing ILECs a "search and destroy" tactic.

[7] FCC 96-489 at para 10.

upon its very entry into the market.[8] This ability will only be exacerbated if the ILEC is provided outright subsidies to ensure that its revenues are not affected by its pricing practices.

A competitive local carrier ("CLC"), will find it no easier to compete, even under circumstances where it can compete on the basis of efficiencies, with a carrier that controls the market and can engage in the type of pricing structures and rates which the Commission proposes in its NPRM here.

CCTA is not saying ILECs should never have access pricing flexibility. CCTA is asserting in the strongest terms that the ability of the ILEC to escape the types of pricing safeguards discussed here must be dependent on the existence of "actual" sustainable, competitive access market in both business and residential segments. The ILECs have the ability to petition the Commission for pricing regulation upon a such a showing. At this point,however, such as

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[8] The Commission should be vigilant to the possibility that the non-discrimination provisions in the Telecommunications Act of 1996 will not prevent anti-competitive abuses in the price of access. As the transcript in a recent CPUC proceeding involving the application of Pacific Bell's proposed 272 Affiliate ("PB Com") for a CPCN indicates, the BOC affiliates may interpret those non-discrimination provisions rather narrowly.

> "Question: Now, if PB Com were purchasing access from Pacific Bell on a customer-specific contract basis and if the price offered to PB Com by Pacific Bell were lower than the price offered to any other competitor in the marketplace, would you not agree that that would be a form of discrimination intended to favor its affiliate?"
>
> Answer: "It might be, but it might not be."
>
> Question: "If the examination showed that the rate offered to [PB Com] was lower than the rate offered to any other carrier in the marketplace, would you agree with me that that would be an appropriate basis for the Commission to reject the contract?"

Answer: "No." (See, Transcript, Vol. 2, at 148, 149, Application of Pacific Bell Communications for a Certificate of Public Convenience and Necessity to Provide InterLATA, IntraLATA and Local Exchange Telecommunications Services Within the State of California, A. 96-03-007.)

when unbundling, 1+ presubscription, full and permanent number portability and the existence of viable CLCs is a mere hope extending from the recent passage of Telecommunications Act, deregulation of these safeguards would be nothing more than a signal from the FCC that it has preselected certain segments of the telecommunications market, i.e., the ILECs, to be the winners in the "competitive" market.

Moreover, the LECs do have the ability to circumvent certain pricing restraints by providing access on an unbundled basis. Most states, including California, are engaged in proceedings to determine long run incremental costs of intrastate access, and to determine appropriate pricing levels that will promote competition and ensure the viability of the ILEC. These types of examinations are critical to a reasoned repricing of access and unbundled elements, and will serve far more efficiently and productively than the removal of competitive safeguards, to drive access pricing to its efficient level, and bring about the competitive benefits to consumers which the Commission seeks.

III. Compensation for Competitive Losses is Antithetical to a Competitive Market.

The Commission has requested comment on the appropriateness of creating a subsidy mechanism to compensate the ILECs for any difference between the direct embedded cost of access and its forward-looking cost.[9] If implemented, this subsidy mechanism would

[9] NPRM at para 256.

essentially provide compensation for competitive losses, a subsidy which is antithetical to a competitive market and a concept which the CPUC has rejected.[10]

There are a number of reasons why such a subsidy mechanism is inappropriate. The NPRM cited NARUC's suggestion that new sources of revenue from ILEC in-region interLATA market entry may constitute a mitigating factor that should be reflected in an evaluation of any difference between embedded and forward-looking economic costs.[11] In addition, since 1989, LECs have been subject to price cap regulation, and under that pricing regulation have ostensibly been at risk for their own investment decisions, and have retained the profit resulting therefrom.[12] Even if the LECs could show a loss between DEC and TSLRIC costs, the LECs today cannot show an anemic rate of return.

The recent dissenting decision by Commissioner Knight in California Docket No. R. 95-04-043/ I.95-04-044 is instructive in this regard. As Commissioner Knight noted,

> As of September of 1996, Pacific Bell had outperformed all other companies in its stock price performance since July of 1995. In fact, it outperformed the S&P 500 over that same time period...Pacific Bell is experiencing tremendous growth in its market. Pacific is coming off a record 2nd quarter, well on its way to a very good year. Pacific Telesis operating income for the first six months of 1996 increased a staggering 18%, $182 million, over the operating income for the first six months of

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[10]CPUC Decision R.95-04-043, I.95-04-044.

[11] NPRM at para 256. <u>See also</u>, Dissenting Opinion of Jesse J. Knight Jr. R. 94004-043, I.94-04-044, December 27, 1996, at 15, expressing concern that the California Commission not ignore "the prize which Pacific sought as the animating goal of the very changes it confronts", <u>i.e.</u>, Pacific's revenues from its long distance operations, in determining the impact of competition on earnings,

[12]Note: General Telephone of California did exceed the highest tier of the cap twice and had some sharing, but Pacific Bell never has.

> 1995. This increase in operating income resulted from a surge in revenues of 5.4% combined with a modest increase in expenses, including depreciation, of just 1.7%. Net income increased by 6.8% reflecting a 5 cent gain, to 66 cents in earnings per share for the 2nd quarter of 1996 over 2nd quarter 1995.[13]

Further, Pacific Bell's unadjusted fourth quarter earnings was 66 cents a share, up from 54 cents a share in fourth quarter 1995 and higher than the 58 cents a share Wall Street expected.[14]

IV. California Has Reduced Intrastate Access Charges and the ILECs Are Thriving.

California is one of many states that have examined and reduced access charges. The CPUC eliminated the CCLC as a revenue source on an immediate basis in a revenue-rebalancing effort that included lowering toll and access rates with little increase in local revenues.[15] The CPUC decision stated that it

> does not agree with [the] proposal to rely on an all end-user surcharge, even to a small degree, to collect the revenue now provided by the CCLC. Even a phased-out surcharge would have undesirable effects. The surcharge would blur the price signals that are the foundation of competitive efficiency. By completely eliminating the CCLC as part of a final rate design, without a phase-out, we will avoid reliance on confusing rate rebalancing surcharges on customer bills and prevent steady multi year

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[13] See Dissenting Opinion of Commissioner Jesse J. Knight, Jr., R. 95-04-043, I. 95-04-044, December 27, 1996 at 12; see also, Attachment 2: New York Times, Wednesday, January 22, 1997, Reporting on Bell Atlantic's Fourth Quarter Earnings indicating that BOCs in general are performing well financially.

[14] Attachment 2.

[15] CPUC Docket No. 87-11-033, In the Matter of Alternative Frameworks for Local Exchange Carriers, Decision 94-09-065. Given that jurisdictional separations allocates a significantly larger portion of CCLC recovery to intrastate revenues, the reduction or elimination of CCLC charges on the state side is even more significant.

> increases in rates for monopoly services. Use of an end-user surcharge to collect revenues now collected by the CCLC is therefore rejected.[16]

To achieve revenue neutrality, and to achieve lower rates for competitive services, the CPUC relied on the stimulation of toll, toll-like services, and switched access services to lessen the need for rate increases.[17] This effort has allowed, as it was intended, the ILECs to compete in the toll and access markets. Rather than having a negative impact on California's ILECs, the ILECs, and particularly Pacific Bell, are thriving in an increasingly competitive access environment. As recently noted in a California proceeding:

> The fact of the matter is that Pacific Bell is selling more access lines now than it did prior to the Commission opening the market....It is an undisputed fact that the access market is booming in California and Pacific Bell is well positioned in this competitive market. It can be argued that Pacific's low access rates are a competitive advantage because its access rates are the lowest in the country and could serve as a competitive deterrent compared to rates in other parts of the country (citing UBS Securities Analysis and Buy Recommendation of Pacific Telesis, July 9, 1996). Intrastate access revenues are up 6.1% for the first half of this year as compared to the first six months of 1995. This is true despite the Commission opening the transport market to competition in 1995 and the existence of several viable facilities-based carriers in this high capacity market. On the interstate side, revenues are also up increasing 5.6% over last year. Despite competition, Pacific has seen its access minutes and its access revenues increase.[18]

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[16] Id. at 121.

[17] Id. at 3.

[18] See Attachment 1, Dissenting Opinion of Commissioner Jessie J. Knight, Jr. R.95-04-043, I.95-04-044, December 27, 1996 at 13. See also Attachment 2, documenting Pacific Bell and other BOC Fourth Quarter earnings.

V. The FCC Should Eliminate Access Subsidy Elements, Allocate Costs to the Cost-Causing Access Element, and Phase Down The Above-cost Subsidy in Access Element Prices

The Commission is aware that subsidies in access are harmful in a number of ways. They provide uneconomic incentives for entry into the local exchange access market, they force access purchasers to pay for competitors' network services, and they increase the price of all services to end users. In the Commission's examination and determination of access issues in this proceeding, retention of untargeted access subsidies will provide the ILECs with a fund to squeeze new entrants from the access market, particularly if the Commission affords increased pricing flexibility.[19] For example, Pacific Bell will be better able to afford targeting a specific CAP's access customers with below-cost access contracts.

The Commission is correct that initially access reform must provide for access charges which reflect the way in which access element cost is incurred, as well as its forward-looking costs This means, for example, that the rate structure reflects that non-traffic sensitive elements should be recovered with a flat-rated charge, and/or that the cost-causer be responsible for the recovery of the costs associated with the local loop.

The Commission also correctly recognizes that the actual rate for access should move, over a reasonable time frame, to its forward-looking costs. Since competition is only nascent, the prescriptive approach is needed until the market can act as the control. This Commission's proposal to eliminate the lower price cap service band indices and easing of some

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[19]Footnote 6, infra at II.

requirements for the introduction of new interstate services makes a prescriptive movement of access rates toward forward looking costs over a transition time frame necessary.

A transition to lower rates for retail network elements that do not have an associated cost, as opposed to an immediate cut, may prevent the ILECs from moving subsidies to a more inelastic service rather than being eliminated. The ability of an ILEC to use subsidies in anticompetitive ways underscores CCTA's concern that pricing flexibility granted prior to the existence of viable competition will operate to prevent the development of competitive alternatives.

Given the limited extent of facilities-based competition, direct, untargeted subsidies must be eliminated on a prescriptive basis. It is clearly arguable whether elements such as the TIC and CCLC recover any actual access cost, and they certainly do not currently reflect cost causative access elements. For example, it has been argued that the CCLC provides for recovery of loop costs. In fact, however, the CCLC was derived from an historical allocation by the LECs to loop costs for the purposes of revenue recovery. As the growth in access minutes has significantly out paced the growth in loops, the revenue from the CCLC has provided a significant subsidy to the LECs, that may well have recovered the cost of loops into the future.

The California Commission, for example, eliminated the CCLC "in keeping with [its] overall policy of cost-based pricing",[20] without financial harm to ILEC revenues. Even if, arguendo, the CCLC does recover some loop cost, and to the extent the Commission assigns

[20]See 87-11-033 at p.6.

such recovery to the non-cost causative rate element, recovery should be incurred on a flat-rated basis, since loop costs are incurred on a flat-rated basis. Similarly, any transport cost recovered by the TIC should be recovered through the transport element, with the non-cost subsidy proscriptively phased-out of the access rate.

VI. Conclusion

For the reasons set forth herein, CCTA urges the Commission to continue to encourage the development of economically sound market structure and access competition by ensuring that reductions in access prices are achieved on the basis of cost-based rates which reflect the manner in which access costs are incurred, that pricing safeguards are enforced until such time as viable competition can reasonably substitute for regulation, and that access subsidies designed to compensate the ILEC for competition losses are rejected.

Dated: January 28, 1997

Respectfully submitted,

CALIFORNIA CABLE TELEVISION ASSOCIATION
Alan J. Gardner, Vice President Regulatory & Legal Affairs
Jerry Yanowitz, Vice President Federal Affairs
Lesla Lehtonen, Assistant General Counsel
Jeffrey Sinsheimer, Director, Federal Affairs

By ______________________
Lesla Lehtonen
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ATTACHMENT 1

STATE OF CALIFORNIA PETE WILSON, Governor

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

December 27, 1996

TO: ALL PARTIES OF RECORD IN R.95-04-043, I.95-04-044

Decision 96-09-089, which addresses telecommunication franchise impact issues in this proceeding, was mailed on October 7, 1996 without the Dissenting Opinion of Commissioner Jessie J. Knight, Jr.

Attached herewith is Commissioner Knight's Dissenting Opinion.

Very truly yours,

Lynn T. Carew

Lynn T. Carew, Chief
Administrative Law Judge

LTC:vdl

Attachment

R. 95-04-043 / I. 95-04-044
D. 96-09-089

COMMISSIONER JESSIE J. KNIGHT, JR., DISSENTING:

In my three years of experience as a Commissioner, never has a decision been so widely debated and analyzed within the California Public Utilities Commission. The issue before us regarding competitive franchise impacts on the incumbent telephone utilities, generated five proposed decisions, as many decisions as there are sitting Commissioners. With such focused, though varied positions, one would have hoped that this collegial body ultimately would be decisive and reach a sage result. Regrettably, this did not happen. In the end, compromise produced a decision which is neither decisive, nor wise in my opinion. Thus, I must strongly dissent from the vote of the majority.

After having dedicated nearly a year of this Commission's limited resources to the franchise impact issue, the decision resolves very little. The majority concludes that this phase of the Local Competition proceeding was premature and that sometime after January 1, 1997, at the behest of Pacific Bell (Pacific) or GTE California, Inc. (GTEC), the interested parties can re-visit the subject again. Additionally, the majority redefines the inquiry and greatly broadens the scope of the postponed Franchise Impact case unnecessarily.

Aside from being a waste of administrative resources, some might view the majority's decision as innocuous, or at least embrace the unfortunate belief that the decision does not deal a detrimental blow to this Commission's long term commitment to the promotion of competition in the telephone industry. I wish this decision truly promulgated so benign a circumstance. I believe that a close reading of the majority opinion will clearly reveal unforeseen and unintentional protection of the incumbent monopolies. The protection that the majority decision affords Pacific and GTEC is unwarranted, unnecessary and potentially destructive to our quest for full competition.

As a result of the majority's decision, Pacific and GTEC emerge as big winners, and perhaps the only winners. Since the utilities could not persuade the Commission to compensate them in any amount, let alone the several billion dollars requested, then the next best outcome for these entities would be an expressly sanctioned opportunity to try again. The majority has provided that opportunity.

Virtually every theory raised in support of the utilities' compensation request is preserved or expanded by the majority decision. Moreover, potential competitors in the local exchange market will find no comfort in the majority's positions. At best, the decision creates a discouraging atmosphere of uncertainty for new entrants into the market. At worst, the decision can be read as a foreboding message that higher economic risk is created because of an enhanced possibility of investment loss for new entrants into the local exchange market in California, as the incumbent monopolies seek to establish a treasure chest of future funds to bolster their economic standing in the emerging competitive world.

The Franchise Impact Claim

The issue before us was prescribed in D.95-07-054 as the examination of whether the rules which

> "'permit local exchange competition alter our regulatory program so that it no longer affords Pacific and GTEC an opportunity to earn a fair return on invested capital. If we find that there is not such an opportunity to earn a fair return, then we shall consider what measures, if any, are appropriate to ensure the fairness of our regulatory policies....We shall also coordinate this hearing with the ... universal service docket(s).'" (D.95-12-062, slip op. p.10, fn. 11 quoting from D.95-07-054, slip op. p. 33.)

In response to the franchise impacts inquiry, Pacific and GTEC claim that they have a constitutional right to be compensated for the adverse effects of local competition because such competition, developed pursuant to this Commission's rules, constitutes a taking under the Fifth Amendment (Takings Clause) and the Fourteenth Amendment (Due Process Clause) of the United States Constitution. The taking argument is framed as the confiscation of shareholder property, either because Pacific and GTEC will be unable to recover past capital investments, or because shareholders will be denied the opportunity to earn a fair return on those investments.

In the case of a claim of taking or confiscation of property, it is axiomatic that the party responsible for the alleged taking be the party to which the claim is directed. In this case, the utilities' claim that this Commission is the entity responsible for local exchange competition and therefore, the Commission is liable for the alleged taking of Pacific and GTEC's right to earn a fair return on invested capital. Prior to February 8, 1996, such a claim might have been credible, because the applicable law (The Telecommunications Act of 1934) gave the states primary jurisdiction over intrastate communication services (See Louisiana Public Service Commission v. F.C.C.) . However, on that date, the United States Congress passed the Telecommunications Act of 1996 (The Act), a statute which reasonably can be understood as effectively extinguishing the utilities' claims of this Commission's culpability in requiring local competition. The Act provides in relevant part:

> "No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." (emphasis added, Public Law 104-104, Section 253 (a).)

> "Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements

> necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." (Id. Section 253 (b).)
>
> "If, after notice and an opportunity for public comment, the Commission determines that a State or local government has permitted or imposed any state, regulation, or legal requirement that violates subsection (a) or (b), the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency." (Id. Section 253 (d).)

During this proceeding, several parties commented on the effect of the Act on the instant franchise impact inquiry. (See discussion of comments in the majority decision, D.96-09-089, slip op. pp. 9-12.). The Coalition and DRA assert that as a result of passage of the Act, the utilities' claims should be dismissed. DRA claims that pursuant to Article VI, clause 2 (the Supremacy Clause), of the United States Constitution, the Act preempts the Commission's regulation of local competition.

"The supremacy clause invalidates all state laws that conflict or interfere with an act of Congress.... DRA points out that both Pacific and GTEC have argued that even with the most favorable local competition rules, they will not have an opportunity to earn a fair return. Therefore, DRA concludes that it is the fact of local competition, and not specific rules, that GTEC and Pacific contend prevents them from earning a fair return. Since the Act preempts the Commission's regulation, DRA asserts that the carriers' claims before this Commission are moot and should be dismissed." (Id., p.10.)

The Coalition argues the principles of traditional fault doctrine, pointing out that "any franchise impacts complained of are caused by the Act and would occur if this Commission were to take no action. Therefore, the carriers have no claim against this Commission." (Id., p. 11.)

Commissioner Daniel Fessler and I reviewed the comments of DRA and the Coalition and found them impressive. We jointly authored an alternate decision in which we concluded the following:

> "The Act mandates local exchange competition. The carriers' witnesses have testified that even under local competition rules that are viewed favorably by the carriers, they will experience a taking. In so stating, the local competition rules themselves are removed from the possible causes of the alleged taking. With passage of the Act, we no longer have the authority to 'remedy' takings by not allowing local competition. Therefore,

> we can not be the cause of claims that we have taken from Pacific and GTEC the opportunity to earn a fair return by authorizing local competition consistent with the Act. With the passage of the Act, the taking claims asserted by Pacific and GTEC are moot and should therefore be dismissed."
>
> "Having arrived at this conclusion, this decision need not address further the evidence presented in support of the takings claims or the arguments on any legal obligations this Commission holds to compensate the carriers." (Knight/Fessler Alternate, R.95-04-043, Local Exchange Franchise Impacts, Item H-3c 6/19/96 Agenda, pp.11-12)

I continue to believe that the Knight/Fessler conclusion is legally correct, pragmatically sound and that its adoption by this Commission would have served the best interests of Californians. It would have provided the kind of expeditious, final result that affirmatively facilitates progress toward the types of competition evidenced in non-regulated industries. It would have been a decisive result that could only serve to promote the accomplishment of our competition goals. It would have been an economical preservation of our scarce resources. It would have provided an invaluable measure of certainty for potential entrants to the local exchange market. This inquiry would have ended without financial or competitive harm to Pacific and GTEC, since the utilities could still have obtained remedy from the federal government, upon proof that the local competition mandate contained in the Act would deprive them of the right to earn a reasonable return on capital investment and that such deprivation was a compensable taking. And last but far from being least, it would have obliterated a future round of government scrutiny from the eventual court disputes over this issue which surely will be forthcoming.

Regrettably, the Commission did not adopt the Knight/Fessler position. The majority does not explain why they did not find the arguments of DRA and the Coalition more compelling, especially since they "agree with the Coalition and DRA that were we to take no action, the takings claim asserted by Pacific and GTEC would still occur." (D.96-09-089, slip op. p.12.)

It is appropriate for us to consider how the majority dismisses the applicability of the Act to the franchise impact inquiry: "whether our local exchange competition rules alters our regulatory program so that Pacific and GTEC are not afforded an opportunity to earn a fair return on invested capital. The majority dismisses, without explanation, the applicability of the Act to the instant franchise impact inquiry and states:

> "In comments on the proposed decision, the carriers argue that the Commission must take the effect of the Act into account. The act mandates local exchange competition. The carriers' witnesses have

> testified that even under local competition rules that are viewed favorably by the carriers, they will experience a taking. As discussed in Section 4.1.1., the impact of competition cannot constitute a taking. Therefore, we will consider the evidence and arguments to determine the impact of our local competition rules together with our depreciation policy on GTEC's and Pacific's opportunity to earn a fair return on their respective investments, including their opportunity to recover the depreciation expense in the emerging competitive telecommunications market." (D.96-09-089, p.13.)

It is my firm conclusion that the recently enacted (February 8,1996) Telecommunications Act of 1996 (the Act) prohibits states from constraining local competition. The taking claims asserted by the utilities now must derive from the Act and not from any local competition rules which this Commission is obliged to develop consistent with the Act. The test for this is simple. May the commission rescind its decision to open the local market to competition? The answer is no. Therefore, local competition is not the result of this Commission's actions.

The taking assertion is further augmented by the claims that by introducing local competition, the Commission abrogates the utilities' "exclusive franchise" and/or the Commission breaches the "regulatory compact" which protects the utilities from competition. Finally, cloaking themselves in the Constitution's Equal Protection Clause, utilities claims that the Commission must provide phone companies with transition cost relief analogous to the non-bypassable Competitive Transition Charge (CTC) provided in our Electric Services Restructuring Decision (D.95-12-063, as modified by D.96-01-009). Pivotal to the utilities' quantification of the taking claims is the accounting mechanism which identifies the companies' impaired assets, described by Pacific as depreciation reserve deficiency or as uneconomic assets by GTEC.

A taking argument is difficult to prove and the courts would tend to give deference to the government agency charged with acting in the public interest. The majority decision provides an apt picture of the taking law, but does not emphasize how difficult a burden the proponent has in such a case. Constitutional taking is not easy to prove, as the following summary of "taking" law suggests. Generally, an unlawful taking or confiscation does not occur unless a regulation or rate is unjust and unreasonable (Duquesne Light Co. v. Barash (1988) 488 U.S. 299, 307; 20th Century Ins. Co. v. Garamendi (1994) 8 Cal.4th 216, 292.) Whether a regulation or rate is just and reasonable depends on the balancing of the interests of the regulated entity providing the services and the interests of the consumers of such services. (Federal Power Com. v. Hope Nat. Gas Co. (1943) 320 U.S. 591, 603; see also, 20th Century Ins. Co. v. Garamendi, supra, 8 Cal.4th at p. 293.) " The just and reasonable" principle does not require "that the cost of each company be ascertained and its rates fixed with respect to its own costs." ' " (Id. citing Giles Lowery Stockyards v. Dept. of Agriculture (5th Cir. 1977) 565 F.2d 321, 327.) "[A] regulated industry is not entitled, as a matter of right, to realize a particular rate of return, and the interests of the consuming public are also to be considered in establishing rates." (Id. at p. 324.) "That a particular rate may not cover the cost of a particular good or service does not work confiscation in and of itself." (20th Century Ins. Co. v. Garamendi, supra, 8 Cal.4th at p. 293.) Further, a regulated entity neither has a constitutional right to a profit nor a constitutional right against a loss. (Id. at p. 294) "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid." (Federal Power Com. v. Hope Nat. Gas Co., supra, 320 U.S.at p. 601). Competition alone cannot constitute adequate grounds for an unconstitutional taking, because the Constitution does not shield a utility from such business hazards (Public Service Commission of Montana v. Great Northern Utilities Co., (1933) 289 U.S. 130, 135). Finally, it appears that an unconstitutional taking will not lie if there is an adequate method for obtaining individualized relief. "Recognizing that virtually any law which sets prices may prove confiscatory in practice, courts have carefully scrutinized such provisions to ensure that the sellers will have an adequate remedy for relief from confiscatory rates." (Calfarm Ins. Co. v. Deukmejian (1989) 48 Cal. 3d 805, 817.)

The majority decision correctly orders denial of the utilities taking claims related to the introduction of competition in their local exchange markets (D.96-09-089, Ordering Paragraph 3). Because the recently enacted (February 8,1996) Telecommunications Act of 1996 (the Act) prohibits states from constraining local competition, the taking claims asserted by the utilities now must derive from the Act and not from any local competition rules which this Commission is obliged to develop consistent with the Act. Accordingly, the taking claims related to local competition rules are moot and should be dismissed.

I find the evidence clear and convincing that a takings has not occurred, nor does it appear that a taking of utility property is likely to occur. I find nothing in the analysis of stock price data that indicates the opening of the local telecommunications market to competition constitutes a taking. Even if one assumes a reduction in the value of the stock price of a utility, that is not, in and of itself, evidence of a taking. The stock price simply reflects the investors expectations of the value of the company at a point in time. Simply a reduction in these expectations does not constitute a taking. In reviewing the financial projections of the telephone companies, I am not convinced that a takings is ever likely to occur. The Commission is only responsible for the effects of its regulatory actions. The government is not responsible for shortfalls in earnings due to competitive losses, for shortfalls that occur as the result of poor managerial decisions, for shortfalls that result because of economic conditions, nor for shortfalls that result from technological change. Rather, it is the obligation of government as regulator, to allow for utilities to have a fair opportunity to earn a fair return on their investments dedicated to public service. In my mind, Pacific still has this opportunity.

The Second Bite at the Apple

The majority decision concludes that, based on the evidence presented, Pacific and GTEC failed to persuade this Commission that the implementation of local exchange competition would adversely impact the utilities' opportunity to earn a fair return on capital investment. That decision should have signaled the end of this case. As a matter of law, decisions made by this Commission are limited by and reflective of the underlying record (Camp Meeker Water System, Inc. v. Public Utilities Com. (1990) 51 Cal.3d 845, 864; see also, California Manufacturers Assn. v. Public Utilities Com. (1979) 24 Cal.3d 263, 265; see also Rule 1.2 of the Commission's Rules of Practice and Procedure, Cal. Code of Regs. tit. 20, paragraph 1.2 which states: "the Commission shall render its decision based on the evidence of record."). If the party seeking a remedy does not carry its burden, then the answer to its inquiries is negative! (Aetna Ins. Co. v. Hyde (1928) 275 U.S. 440, 447-448).

In this case, Pacific and GTEC did not carry their burden. In fact, according to the majority, the utilities' quantitative evidence of adverse impact on future earnings is so speculative that "it should be given no weight." (D.96-09-089, slip op. p. 59). Despite this clear rejection of the quantitative evidence, it is curious that the majority excuses the utilities' unpersuasive presentations:

> "This speculation was necessary due to the timing of this proceeding. Testimony was submitted before our local exchange competition rules were adopted." (D.96-09-089, slip op. p. 59.)

Inexplicably, the majority perceives prematureness as a relevant concern, even though the applicant utilities did not. The utilities chose the evidence and made their showing knowing full well that the franchise impact issues would be heard before resolution of the Commission's local competition interim rules. Furthermore, the utilities' testimony apparently anticipates the question of prematureness and deems it irrelevant. Both Pacific and GTEC conclude that their respective positions on the franchise impact issue will be unaffected by the outcome of the Commission's local competition rules.

> "Pacific's witness Darbee testified that Pacific will not have an opportunity to earn a fair return even if all the then-pending local exchange competition rules were resolved in Pacific's favor. GTEC's witness MacAvoy presented testimony which arrived at the same conclusion." (D.96-09-089, Finding of Fact 1, p.67.)

The majority's express invitation to the utilities to renew their request for franchise impact compensation "after January 1, 1997" was neither a legal nor a pragmatic necessity. Pacific and

GTEC management are quite familiar with Commission procedures and are fully cognizant of all the routes to gain Commission reconsideration of any matter they may have concern. Furthermore, the cornerstone of the utilities' compensation request, the constitutional taking argument, always can be renewed, particularly when changed circumstances or new facts form the basis for the renewed request. Therefore, it seems clear that the majority's reapplication invitation was not necessary. Moreover, when one considers the utilities' evidentiary decisions in the instant proceeding, it appears that the invitation also was undeserved. When one considers the utilities' "excused" speculative testimony and the reapplication invitation together, the following statement from the majority decision seems to have special importance:

> "We reemphasize the important distinction we made ... between protecting the carriers from competition -- which the Commission will not do -- and mitigating any deprivation of the carriers' opportunity to earn a fair return on their investment resulting from our (sic) adopted new regulatory program and on-going NRF regulation. The carriers should be careful to reflect this distinction in any presentation of evidence that our regulatory program deprives them of the opportunity to earn a fair return. We note that though the concept of losses due to competition was debated, <u>the parties did not debate the local competition assumptions Pacific applied in the scenarios it presented. These scenarios, although speculative, provide us with a sense of the possible impact of regulatory and market outcomes which we would like to further consider once our new regulatory programs have been completed.</u>" (D.96-09-089, p. 61.)

It is unclear whether the majority was positively impressed by the speculative quantitative evidence or simply wanted to see if the speculation became fact once the "new regulatory programs" become effective. It is unclear whether the majority felt that only the "debate" on Pacific's local competition assumptions were missing. As intimated by the above citation, it appears that the utility scenarios serve as the basis for the revised franchise impact inquiry which the majority adopts. A more troubling reading is whether the utility "scenarios" have become the blue print for the majority's revision of the franchise impact inquiry. Knowing and respecting the view of each of my colleagues in the majority regarding to their individual beliefs on competition, I am not persuaded that the latter is true. Each Commissioner is thoroughly dedicated to the rapid evolution of competition. I only highlight the possible misinterpretation by less informed parties who may become involved in some future inquiry of the Commission.

The New Franchise Impact Issue - A Big Target

Certainly the majority's reapplication invitation says more than "come back". Instead of considering the utilities' opportunities to earn a fair return in the context of local exchange